Business Combinations Desk Book

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1 Introduction

Department of Defense (DoD) research, development, and acquisition policies, as well as funding and program decisions, have a major impact on competition and industry structure. Generally, DoD assessments of proposed business combinations (domestic and foreign firm mergers, acquisitions, and joint ventures) must complement such policies and decisions to sustain credible competition in an evolving industrial environment.

This deskbook describes the processes that the Department uses to ensure that its evaluations of proposed business combinations:

- facilitate the creation and maintenance of a competitive, cost-effective industrial base;
- protect the industrial and technological capabilities needed to supply critical warfighting products;
- provide a robust foundation from which DoD decision makers can develop a Department view;
- provide a timely, fair review for the companies (parties) involved; and
- ensure a single DoD voice within the interagency review process, and a coordinated U.S. Government position to the companies.

The processes described in this deskbook are analytically rigorous yet sufficiently flexible to take into account the unique circumstances of individual business combinations.

The Department's challenge is to establish, maintain, and strengthen industrial relationships that ensure that the defense industrial base is both healthy and capable. In doing so, the Department also must balance the need to encourage competitive forces for cost control and innovation with the desire of companies to combine with other firms to realize efficiencies, create integrated, more capable industrial capabilities, or eliminate excess capacity.

This deskbook provides procedural guidance and context for the Department's review of business combinations involving defense suppliers. The concepts, processes, and analyses described herein apply to:

(1) proposed mergers or acquisitions for which filings have been made pursuant to the Hart Scott Rodino Antitrust Improvement Act of 1976;

(2) proposed acquisitions of U.S. defense contractors by non-U.S. firms for which filings have been made to the Committee on Foreign Investment in the United States

(CFIUS), pursuant to the Exon-Florio Amendment to the Omnibus Trade and Competitiveness Act of 1988, as amended by the Foreign Investment and National Security Act of 2007, and contained in section 721 of the Defense Production Act;

(3) other collaborations (joint ventures, mergers and acquisitions) among competitors that have been made public that are of special interest to the Department that do not meet the Hart Scott Rodino Act filing threshold or have not been filed with CFIUS; and

(4) proposed corporate transactions forming a new company or entity (e.g. spinoffs) – (Note: this is recognized as not a business combination, but are to be accordingly assessed.)

2 Defense Business Combinations

2.1 The Importance of Competition

Robust, credible competition is vital to providing the Department with high quality, affordable, and innovative products. Competition produces innovation and industrial efficiencies that lead to improved affordability. The innovation that competition stimulates in defense markets is paramount in an unsafe world where technological superiority on the battlefield provides critical military advantage. DoD's responsibility is to foster an appropriate enabling framework for industrial development and competition in defense markets that are marked by dynamic change. The Department believes that the competitive pressure of the marketplace is the best vehicle to shape an industrial environment that supports the defense strategy. Therefore, the Department of Defense takes action to intervene in the marketplace only when necessary to maintain appropriate competition and develop and/or preserve industrial and technological capabilities essential to defense that the marketplace, left unattended, would not.

2.2 Sustaining Competition

Sustaining competition poses special challenges. As the defense industry evolves, the Department seeks to sustain effective competition by considering several factors:

- The need to sustain multiple competitors for legacy industrial capabilities is significantly different than the need to develop and maintain potential competitors able to develop product lines requiring high levels of innovation.

- Vertical integration and the resulting influence on companies' make/buy decisions, or decisions to no longer act as a merchant supplier to other firms, could impact the Department's ability to acquire the best mix of capabilities from industry.

- As a consequence of worldwide defense industry consolidation and collaboration, the Department must determine the effects of competition from non-U.S. defense firms on the anti-competitive risks associated with U.S. defense firm combinations.

- The Department also must assess whether foreign firm acquisitions of U.S. defense firms likely will result in the transfer of critical technologies from the U.S. industrial landscape or present risks to supply chain reliability and integrity.

2.3 DoD and the Shape of the Defense Industry

As the principal customer, DoD influences the shape of the defense industry through its research, development and acquisition plans, budgets, evaluations, and decisions. The Department's decisions must take a long view on competition.

While market forces and a strong budget normally sustain credible competitive sources, for some critical defense products the number of suppliers may be limited. As the defense industrial base "right-sizes" itself, the domestic industrial firms in certain mature product areas may become unsustainable and competition from abroad may complement a remaining U.S. source. On the other hand, new entrants to the defense industrial base may represent sole sources of technologies until sufficiently large requirements induce other competitive sources.

The Department participates in Executive Branch reviews of proposed business combinations that, in fact, have the authority to intervene in the market – by blocking the combination – where necessary to preserve competition, industrial and technological capabilities, technology security, and supply chain reliability and integrity. The Department participates in reviews conducted by antitrust agencies for proposed mergers or acquisitions under the Hart-Scott-Rodino Antitrust Improvement Act and on reviews conducted by the interagency Committee on Foreign Investment in the United States (CFIUS) for proposed foreign acquisitions of U.S. firms that produce goods and services relevant to national defense or critical infrastructure.

Evaluating the consequences of a proposed business combination can be done only on a case-by-case basis. There is no single criterion for all occasions. Given the consolidated industrial structure and a constrained defense modernization budget, the Department must ensure that its actions foster an environment that develops and sustains a sufficient number of capable competitors in core defense markets.

3 DoD Mergers and Acquisitions (M&A) Reviews

The Department monitors proposed business combinations involving defense-related firms and selectively identifies transactions for evaluation. Out of the hundreds of defense-related transactions each year, the Department selectively engages on transactions for review which represent a potential harm – apart from issues addressed in the CFIUS process. Major transactions normally involve working closely with the Antitrust Agencies to facilitate the Department's review and to support the antitrust review. The antitrust reviews and the Department's internal reviews are usually conducted jointly. However, the Department occasionally investigates and responds to transactions and issues that relate to concerns outside of antitrust or CFIUS reviews or are transactions that do not rise to the levels sufficient for antitrust agency action.

3.1 Antitrust Reviews

Mergers and acquisitions are subject to regulatory review to enforce several legislative acts regarding anticompetitive behavior. For example:

- Section 7 of the Clayton Antitrust Act of 1914 (15 USC Chapter 1): prohibited if their effect "may be substantially to lessen competition, or to tend to create a monopoly";

- Section 1 of the Sherman Antitrust Act of 1890 (15 USC Chapter 1): prohibited if they constitute a "contract, combination . . . , or conspiracy in restraint of trade"; and

- Section 5 of the Hart–Scott–Rodino Antitrust Improvements Act (15 USC Chapter 1): prohibited if they constitute an "unfair method of competition".

The antitrust laws are enforced by both the Federal Trade Commission's (FTC's) Bureau of Competition and the Department of Justice's (DoJ's) Antitrust Division. In order to prevent duplicative efforts, the two agencies consult with each other before opening any case, and "clearance" is granted to an agency.

The Hart-Scott-Rodino Antitrust Improvement Act provides filing requirements and time periods for companies (parties) proposing mergers. A generalized timeline is shown in Figure 1. The time periods encourage the antitrust agencies to expedite their investigation and enforcement decisions. For mergers or acquisitions above a certain size, the parties must provide prior notification, via a pre-merger filing, to the FTC and the DoJ. The pre-merger filing includes analyses or reports prepared by the company for the purpose of internal transaction decisions; the acquisition agreement; and other relevant documents. Once filings have been submitted, either the FTC or DoJ reviews the proposed transaction for possible antitrust concerns. The transaction thresholds for filing pre-merger notification under the Hart-Scott-Rodino Act do not preclude antitrust reviews and enforcement for transactions below the thresholds. In addition, the antitrust agency can review and file suit for anticompetitive combinations after a merger has taken place.

Once filings are submitted, companies wait an initial 30 days (15 days for an all-cash transaction) while the antitrust agency conducts its investigation. The companies may consummate the merger or acquisition at the end of the waiting period or earlier if the antitrust agency terminates its review. The antitrust agency may issue a request for additional information (a "second request") to both parties prior to expiration of the initial Hart-Scott-Rodino review period, which extends the review period until all parties have complied with the request (or, in the case of a tender offer or a bankruptcy sale, after the acquiring person complies). This additional time provides the reviewing agency with the opportunity to analyze the information and to take appropriate action before the transaction is consummated.

Once the merging parties certify satisfactorily that they are in substantial compliance with a second request, the antitrust agency has 30 days to bring an action blocking the proposed transaction in federal court; seek remedies that would mitigate antitrust objections; or allow the merger. In the case of a cash offer, the reviewing agency has 15 days from substantial compliance to take action. If the reviewing agency believes that a proposed transaction may substantially lessen competition, it may seek an injunction in federal district court to prohibit consummation of the transaction. If no action is taken within the allotted time period, the parties may consummate the transaction.

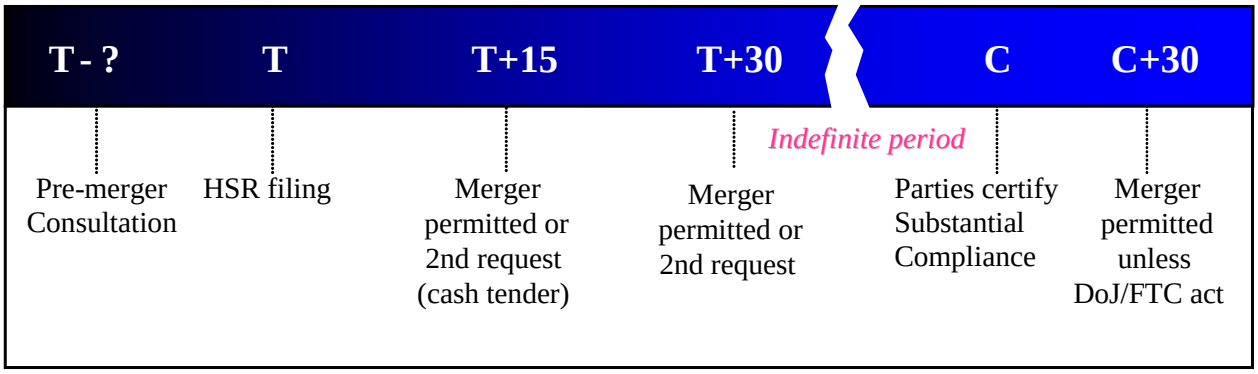

Figure 1 – Hart-Scott-Rodino Timeline

3.2 The Department and Antitrust Reviews

Prior to 1994, the Department generally did not take formal positions with the antitrust agencies on proposed mergers or acquisitions. However, in 1994, in the midst of significant industry consolidation, the Department chartered the Defense Science Board Task Force on Antitrust Aspects of Defense Industry Consolidation to advise how it should formulate and express its views on proposed mergers. The Task Force report noted that, over the previous twenty years, the Department had not taken a formal position supporting or opposing mergers except those that led to foreign ownership of vital technologies. The report further noted that, in the past, individual DoD employees often expressed their opinions and that, in several instances, DoD officials took opposing positions on the same transaction. The Task Force report concluded that competition in the defense industry differs from commercial industry, and that flexibility in the antitrust merger guidelines would allow the antitrust agencies to consider unique defense circumstances in their evaluations. The report recommended that the Department establish an

institutional capacity to assess mergers and then communicate its views on a transaction to the antitrust agencies.

The Department agreed with these recommendations and promulgated related polices, responsibilities, and protocols in DoD Directive 5000.62, *Impact of Mergers or Acquisitions of Major DoD Suppliers on DoD Programs* (October 21, 1996). This directive states that the Department opposes mergers or acquisitions that create unhealthy or unfair competition for DoD systems, components, and services. However, it also provides for mitigation measures and enforcement mechanisms that can allow transactions to go forward.

3.3 DoD's Internal Review Process

As the primary customer impacted by defense business combinations, DoD's views are particularly significant because of its special insight into a proposed merger's impact on innovation, competition, national security, and the defense industrial base. Department reviews also provide a robust foundation from which DoD decision makers can develop a uniform view; provide a timely, fair review for the parties involved; ensure a single DoD voice to the antitrust agencies; and provide a coordinated U.S. Government position on the transaction. Accordingly, the Department has established a formal, rigorous process to develop and communicate its views on proposed transactions to the antitrust agencies. Business combinations that do not meet the HSR filing thresholds, but that might adversely affect the competitive landscape, such as joint ventures, teaming arrangements, acquisitions of foreign companies by U.S. companies, and acquisitions of U.S. firms by foreign entities, may also be reviewed using this process.

3.4 DoD Review Considerations

Most of the time, the Department conducts its review concurrently and collaboratively with the responsible antitrust agency. The Department evaluates the:

- Market and market concentration. Further analyses are generally not required when mergers do not significantly increase market concentration or the largest firm's market share.

- Potential adverse competitive effects of the merger. Market concentration affects the likelihood that one firm, or a small group of firms, could successfully exercise market power to the detriment of the customer(s) in the form of less innovation, higher prices, and/or reduced availability.

- Extent to which entry barriers discourage new entrants. A merger is not likely to create or enhance market power, or to facilitate the exercise of market power, if entry into the market is so easy that the pricing power of the acquirer could be diluted by other participants.

- Efficiencies and other benefits of the merger. Efficiencies generated through mergers can enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products.

DoD reviews are managed as a deliberative process in anticipation of litigation and conducted under strict confidentiality standards. They are structured to identify impacts on national security and on defense industrial capabilities; evaluate the potential for loss of competition for current and future DoD programs, contracts and subcontracts, and for future technologies of interest to the Department; and address any other factors resulting from the proposed combination that may adversely affect the satisfactory completion of current or future DoD programs or operations. The following considerations are illustrative.

Review Considerations

When first considering the potential impacts of a proposed business combination, the Department considers broad assessment areas:

- Does the proposed transaction involve critical technology or raise national security concerns?

- Does the proposal pose horizontal or vertical competition concerns?

- Are there potential antitrust concerns that must be remedied? If so, what adjustments (remedies) could be made that would alleviate the Department's concerns?

- Does the proposed transaction introduce long-term risks or potential harm to the Department aside from traditional antitrust/competition issues?

Based on its initial review, the Department normally would: (1) notify the antitrust agency that it has no objections, or (2) cooperate with the Agency to pursue a second request for additional information from the companies.

The Department would not normally object to a transaction if:

- There is little or no impact from horizontal competitive effects. That is, there are no identified horizontal overlaps; market concentration is not increased significantly; horizontal overlaps exist, but credible competitors abound; or the companies are not competitors in current and upcoming DoD major acquisition program competitions.

- There is little or no impact from vertical integration. That is, there are no identified vertical supply relationships and no exclusive supply agreements; or there is some vertical integration, but market competition exists; or there is little likelihood of future harm (for example, because competitors also have access to vertical products).

- There are no identified organizational conflicts of interest.

- There are no complainants citing horizontal competitive effects or vertical integration concerns; or the nature of the market does not support a complainant's concerns.

- The resultant business combination will likely be financially stable; will likely continue to meet the Department's needs; and have sufficient investment resources for future needs.

If the Department determines that it requires additional information before it can render its recommendations to the antitrust agency, the Department may help the antitrust agency prepare and issue a second request for information; and then conduct a detailed analysis of all available information. The Department and the antitrust agency make every effort to narrow the scope of the second request to require only information essential for the review. The antitrust agency encourages the companies to provide information on a "rolling basis" in order to expedite the review process to the maximum extent possible.

In its review, the Department performs a competitive market analysis, financial analysis, transaction benefits analysis, and an analysis to identify and evaluate potential remedies.

In its competitive market analysis, the Department:

- defines the product markets for all horizontal overlaps and vertical relationships;

- assesses the likely competitive effects of the transaction for each market segment, based on current and future market demand and current and/or potential suppliers; and

- evaluates factors that might alter the market in the future (for example, technology/innovation trends, changing customer requirements, and changing business relationships).

In its financial analysis, the Department determines if the acquiring company likely will be able to finance and sustain the business. The Department also assesses the financial viability of the company being acquired to determine if it has the financial capabilities to continue in business if the transaction is not completed.

In its transaction benefits analysis, the Department identifies and evaluates, with the antitrust agency, potential restructuring actions, vertical efficiencies, and the resulting savings the Department would accrue.

Resolving Issues

During the course of the review, the Department and antitrust agency may communicate potential concerns to the companies. The Department, antitrust agency, and companies then discuss, and may negotiate, remedies to mitigate concerns, including:

- information firewalls to protect proprietary information,

- agreements to rescind exclusive teaming arrangements, and
- targeted divestitures of businesses and/or individual contracts.

These remedies may be included in a consent decree and be appropriate, effective, enforceable, and consistent with maintaining competition and innovation. A consent decree will require specific actions to be taken.

For concerns that do not warrant antitrust intervention, the Department can take independent action working cooperatively with the merging companies. Where organizational conflicts of interests are identified, the parties may rely on contract provisions, may establish firewalls, or may transfer contracts to an alternate source to protect proprietary information. Where vertical integration concerns are identified, the Department may request merchant supplier assurances or may request increased visibility into make/buy decisions. Where horizontal concentrations are identified, the Department may alter specific program acquisition strategies to ensure additional competitive pressures are maintained. Where financial concerns are identified, the Department may monitor the companies' financial and investment activities for negative trends that affect the Department's programs.

By carefully evaluating the effects of a proposed business combination – and clearly and expeditiously articulating its views to the appropriate antitrust agency – the Department can ensure that consolidation in the defense industry occurs in a way that protects national security as well as financial resources. The Department's views on the impact that a proposed combination would have on cost-effectiveness, preservation of a healthy research, development and production capacity, preservation of a skilled workforce, and assurance of efficiency and quality will help shape the antitrust agency's ultimate decision to permit or seek to block a proposed business combination.

After the Department communicates its views to the appropriate antitrust agency, that agency may: (1) allow the transaction to be consummated without change; (2) negotiate remedies with the acquiring company that will mitigate U.S. Government concerns; or (3) bring action in federal court to block the transaction.

4 Foreign Acquisitions of U.S. Defense Contractors

4.1 The Exon-Florio Amendment (Section 721 of the Defense Production Act)

The Exon-Florio Amendment to the Omnibus Trade and Competitiveness Act of 1988 (P.L.100-418) created section 721 of the Defense Production Act to authorize the President to suspend or block foreign acquisitions, mergers, or takeovers of U.S. firms when credible threats to national security, arising from a transaction, cannot be resolved through other provisions of law.[1] The President initially delegated management of the Exon-Florio Amendment to the interagency Committee on Foreign Investment in the United States (CFIUS), chaired by the Department of the Treasury. However, amendments to Exon-Florio enacted in the Financial Investment and National Security Act of 2007 (FINSA) statutorily establish CFIUS with the function of managing national security reviews under section 721. More information can be found at http:// www.treasury.gov/about/organizational-structure/offices/International-Affairs/Pages/cfius-index.aspx.

After the FINSA amendments, CFIUS has nine permanent members (the Departments of Treasury (chair), Defense, State, Justice, Commerce, Homeland Security, Energy, the Office of the United States Trade Representative; and the Office of Science and Technology Policy). Several other organizations within the Executive Office of the President attend as non-voting members. In addition, the Director of National Intelligence and the Secretary of Labor are non-voting, *ex-officio* members of CFIUS.

As is the case for antitrust reviews conducted pursuant to the Hart-Scott-Rodino Act, section 721 prescribes time limits for the CFIUS review shown in the figure below.

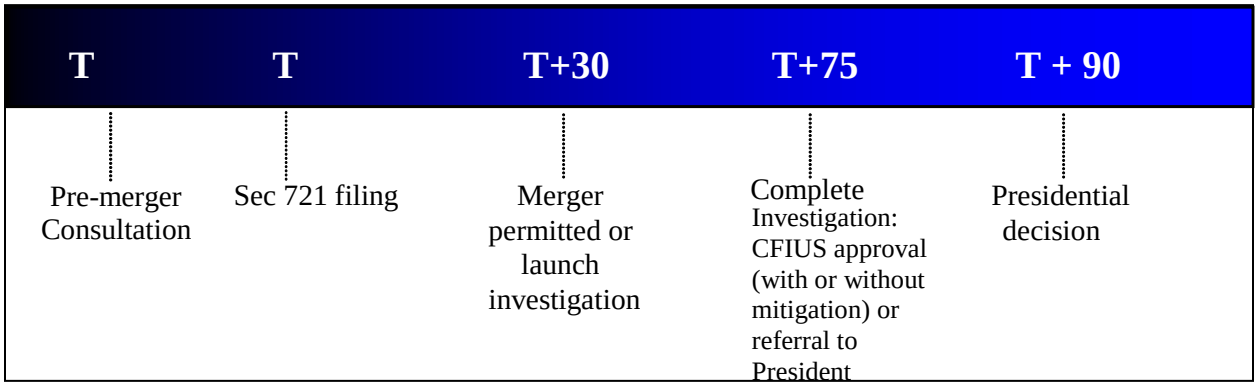

Figure 2 – CFIUS Timeline

Notification is voluntary on the part of the parties to a transaction. However, if they do not file, CFIUS can initiate its own investigation of the transaction. Under section 721 as amended, the President has 30 days from notification of a foreign acquisition to initiate an

[1] One provision of law specifically excepted is the International Emergency Economic Powers Act which enables the President to prohibit virtually any economic transaction involving a foreign country or entity after declaring that a national emergency exists with respect to the threat from that country or entity. This act does not need to be exercised prior to use of the powers under Exon-Florio which addresses individual transactions.

investigation of the transaction. During the first 30 days after formal notification, CFIUS members conduct a preliminary review to determine whether the transaction poses potential "credible threats" to national security and, if so, whether there are means to adequately mitigate those threats. By the 30th day, the CFIUS must either approve the transaction, with or without risk mitigation measures, or initiate an investigation to further examine potential national security threats and possible mitigation measures to eliminate those threats. Under the most recent federal regulations codifying FINSA (31 C.F.R. Part 800) which took effect December 22, 2008, and Executive Order 13456 governing the CFIUS process (January 23, 2008), if the CFIUS begins an investigation, it must approve the transaction within 45 days with or without mitigation, or refer the case to the President if it is recommending a block, is deadlocked, or has some other reason for sending the case to the President. The President then has 15 additional days to decide what action to take. Also, under the FINSA Amendments, the Committee can, at the end of the 45-day investigation, impose mitigation on the transaction without sending the case to the President. The option is usually reserved for situations where mitigation negotiations with the parties have failed and the Committee has developed a consensus on what mitigation to impose.

Other major changes in the CFIUS process mandated by FINSA in 2007 include:

- A lead agency or agencies will be assigned by the Treasury Department for each case and assignment will be based on which members have equities impacted by the transaction. The lead agency, with approval from the Committee, can negotiate mitigation agreements with the parties. As a matter of practice, Treasury assigns itself as a co-lead agency, as well as designating at least one other co-lead for each case.
- Requests for investigation by CFIUS members must be justified by a Risk-Based Analysis (RBA). CFIUS internal guidelines have added that lead agencies cannot begin mitigation negotiations until a Term Sheet, containing the fundamentals of a proposed mitigation arrangement, has been approved by the Committee.
- Investigations will be mandatory for all cases involving Foreign Government Control or National Critical Infrastructure unless the Treasury Secretary and the co-lead agency, at the level of agency head or deputy agency head, certify that a waiver of investigation will not impair the national security of the United States.
- The Treasury Department and co-lead agency at the level of a Presidentially-appointed and Senate confirmed official must jointly certify to Congress that there are no unresolved national security concerns when cases are cleared at the end of the 30-day review. At the end of investigations, such certifications must be signed at the agency head or deputy agency head level if the case is being approved.
- The parties must certify to CFIUS that the information in filings and mitigation agreements is complete and accurate.
- The list of factors that the Committee is to consider when reviewing a transaction was expanded to include explicitly critical infrastructure, energy and critical resources, impact on critical technologies, and whether the buyer is from a country that is a potential regional military threat.
- CFIUS was given the authority to reopen an investigation if the parties submitted false information or intentionally breached a mitigation agreement.

- Any member agency now has the authority to have the Committee open an investigation of a non-notified covered transaction if it submits such a request at the level of an appropriate under secretary.
- The Director of National Intelligence (DNI) is responsible for producing a National Security Threat Assessment (NSTA) on each case with the NTSA due by the 20th day after CFIUS notification.
- Annual reporting requirements to Congress by the CFIUS chair were greatly expanded to include compliance with mitigation agreements, CFIUS case trends, trends in foreign direct investment, and any coordinated efforts by two or more companies or countries to gain control of U.S. critical technologies or engage in industrial espionage.

In 1992, amendments to Exon-Florio added section 2537 (c) to title 10 of the U.S. Code requiring the Secretary of Defense to determine if the company or business unit being acquired in a CFIUS case possesses critical defense technology under development or is otherwise important to the defense industrial and technology base. If the Secretary determines that either of these criteria is met, one of several DoD intelligence agencies must prepare an Assessment of the Risk of Technology Diversion and share that assessment with all CFIUS members. The Under Secretary of Defense (AT&L) has been delegated the authority to make the technology and industrial base determinations.

Since 1988, CFIUS has reviewed well over 2,000 transactions, the vast majority of which were approved. However, the number of cases that result in investigation has increased since the enactment of FINSA, in part because of the mandatory investigation provisions for two categories of cases. Very few transactions result in an actual block or abandonment because most transactions that involve risks to national security arising from the transaction have such issues resolved by risk mitigation measures negotiated by CFIUS or, for cases with classified contracts or where the acquired firm has a facility clearance, by measures imposed under the USG industrial security regulations for mitigation of Foreign Ownership, Control, or Influence (FOCI).

4.2 DoD's Internal Review Process

Since October 1, 2011, the Office of the Deputy Assistant Secretary of Defense for Manufacturing & Industrial Base Policy (MIBP) within OUSD(AT&L) is the DoD lead for CFIUS reviews. A total of 20 DoD components must provide their views on a CFIUS case to MIBP by the 21st day after the case is filed. The responsibilities of the DoD lead organization and of each DoD component which reviews individual CFIUS case are outlined in DoDI 2000.25. While the procedures followed by the DoD CFIUS participants in DoDI 2000.25 remain the same, the instruction will be reissued as an AT&L instruction reflecting the functional move from OUSD(Policy).

Under DoDI 2000.25, the components with responsibilities to review cases include relevant offices within OUSD(AT&L) including ASD(Research & Engineering), ASD(Logistics & Materiel Readiness), the DASDs for Strategic and Tactical Systems , Space & Intelligence,

and C3& Cyber, DUSD(Installations & Environment), and Director, Special Programs among others; USD(Intelligence); several offices within OUSD(P) including the Defense Technology Security Administration and those offices with regional expertise plus the Assistant Secretaries for Homeland Defense and Global Security Affairs; ASD(CIO), the Military Departments; the Joint Staff; certain Combatant Commanders; OSD's Office of General Counsel; and the following Defense Agencies: Defense Security Service, Defense Logistics Agency, Missile Defense Agency, National Reconnaissance Agency, Defense Intelligence Agency, National Security Agency, Defense Information Systems Agency, and Defense Advanced Research Projects Agency.

Major features of DoDI 2000.25 that impact the various DoD components responsible for reviews of CFIUS cases include:

- Requirements for any paperwork requesting a CFIUS review of a non-notified transaction;
- Participation in development of any DoD position on whether a transaction has CFIUS jurisdiction;
- Responsibilities of any component that is granted co-lead status with MIBP within the DoD review process under a "Fast Track" procedure for cases where such a component may have special expertise or there is urgency to get the transaction to senior DoD management quicker than normal;
- Responsibilities of components for sharing in mitigation compliance monitoring for mitigation agreements they requested and also participating in a DoD CFIUS Monitoring Committee chaired by MIBP;
- The full list of factors that components should consider in providing their views to MIBP on cases during initial 30-day review;
- Matters that must be addressed in any recommendation to MIBP for an additional 45-day investigation of a case, including a Risk-Based Analysis (RBA);
- Details on what must be considered in an RBA. The overall RBA framework is described as consisting of four phases: threat posed by the buyer; vulnerability of the U.S. assets being acquired; consequences to national security if the threat is realized; and overall risk arising out of the transaction before and after feasible mitigation measures.

4.3 Key Substantive Issues in DoD Review

Although section 721 of the DPA as amended contains a list of 12 factors to be considered in reviewing a CFIUS case (which are cited in DoDI 2000.25), the major ones from an AT&L perspective are as follows:

- The nature of the technology possessed by the firm being acquired. For example, the presence of critical defense technology, either under development or mature, or the presence of technology that is export-controlled under the International Traffic in Arms Regulations (ITAR) or that requires a validated license for export under the Export Administration Regulations covering dual use commodities, enhances the scrutiny that a transaction should receive. Increasingly, the Department is concerned

about transfer of dual use technologies and technologies possessed by less traditional suppliers that are relevant to network-centric warfare (such as information technologies) and those technologies of interest to terrorist and counter-terrorist activities (such as producers of fertilizer and bio-chemical detection equipment).

- Any threats to the reliability of the acquired firm as a supplier of defense-related goods and services to the DoD including the integrity of those goods and services.

- Unique production capabilities. The extent to which the firm being acquired has unique production capabilities (for example, it is a sole source supplier to the Department or possesses state-of-the-art manufacturing technology) or is otherwise important to the defense industrial and technology base.

- The level of any classified contracts. Generally, the higher the level of classification, the greater the potential risks to national security if the risk is not properly mitigated. Under the National Industrial Security Program Operating Manual and its FOCI mitigation program, there are several mitigation measures for corporate governance including:

    1) A Special Security Agreement requiring the appointment of several DoD approved, U.S. citizen, cleared Outside Directors for the Board of the acquired firm in cases where the foreign firm is acquiring majority control of the U.S. firm.

    2) A Proxy Agreement or Voting Trust in which the Proxy Holders or Trustees are DoD approved, cleared U.S. citizens for cases in which a foreign firm is acquiring majority control of a U.S. firm and the potential threats to national security are particularly great (e.g., the combination of Foreign Government Control of the buyer and Proscribed Information contracts possessed by the seller).

    3) A Security Control Agreement in which at least one DoD-approved, U.S. citizen, cleared Outside Director may be appointed to the Board of the acquired firm in those cases where the foreign firm is acquiring a minority interest in the U.S.-located firm.

- The extent and nature of the foreign control of the acquired firm. A majority foreign ownership interest in the acquiring firm can pose a greater potential threat to national security. Moreover, if the acquiring firm is owned, controlled, or influenced by a foreign government, the scrutiny of the review is enhanced.

- The record of the acquiring firm and its host country in complying with U.S. export control laws and international agreements relating to technology transfer. The record includes compliance regarding nonproliferation of weapons of mass destruction, missile technology control regimes, and combating international terrorism.

- The extent to which the acquiring company and country engage in defense-related trade with countries of concern. This includes both products and technologies that would be export-controlled under the State Department ITAR regulations if produced in the U.S. as well as items and technologies that are considered dual use and would be export-controlled by the Commerce Department's EAR regulations if produced in the U.S.

DoDI 2000.25 also highlights several other factors to be considered in a CFIUS case review, including whether the acquired firm is part of the DoD Defense Critical Infrastructure; whether the transaction would negatively impact the Defense Critical Infrastructure Program (DCIP); and whether there are relevant DoD concerns or policies regarding any of the foreign countries or governments involved in the transaction.

The DoD's position on each CFIUS transaction is decided on a case-by-case basis. Representatives from MIBP establish a coordinated DoD position on the transaction, including risk mitigation matters if necessary. Once MIBP formulates a DoD position on a case based on the inputs of the various respondents, it is forwarded in a decision package to the Principal Deputy Under Secretary of Defense for AT&L. Major cases and those requiring certification by a deputy agency head are further forwarded to the Deputy Secretary of Defense for review and decision on the final DoD position.

5 Conclusion

Each year there are thousands of mergers and acquisitions involving U.S. companies. The Department has generally supported the process of industry self-restructuring, because it enables firms to eliminate excess capacity, reduces costs, and provides better value for DoD and the U.S. taxpayer. Mergers and acquisitions may allow established firms to assimilate innovation from emerging defense suppliers and provide smaller firms the ability to leverage their innovation across the broader scale of larger companies—and monetize their own intellectual and capital investments. At the same time, the Department does not support transactions that reduce competition for DoD programs; introduce risks or issues; or pose a threat to national security.

The U.S. government's review of antitrust mergers is analytically rigorous and is conducted using well-defined criteria and procedures. Similarly, our policies regarding acquisitions of U.S. defense-related companies by foreign parties are less restrictive than those of many other countries. Our reviews of business combinations ensure we can continue to rely on a secure, competitive industrial base in meeting our warfighting needs while being sufficiently flexible for unique circumstances. These reviews are especially relevant as the Department increasingly focuses its requirements and acquisition processes on operational capabilities sectors – thus allowing for a broader contextual view of the impact of a merger of capabilities.

The Department's policies and procedures outlined in this deskbook will help to ensure an appropriate enabling environment that allows firms involved in defense to compete,

rationalize operations, and, in so doing, provide affordable and innovative products to meet our national security needs.